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Fed Fix Works for Now

Mortgage-Bond Market Breathes Sigh of Relief, But the Calm Is Fragile

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The Federal Reserve's latest dose of medicine to calm the credit crunch appears to be working in at least the all-important mortgage-bond market where yields have dropped in recent days.

"Every little bit of support in the mortgage market helps every other single market out there," said Jim Vogel, head of agency debt research at securities firm FTN Financial. "The Fed, by a combination of actions, is giving people more assurance that things are better for now."

The sigh of relief in the $4.1 trillion market for bonds guaranteed by Fannie Mae and Freddie Mac came even as investors in other fixed-income markets, stocks and commodities grew negative yesterday following the euphoria over Tuesday's 0.75 percentage point cut in short-term interest rates by the Fed. Ultimately, though, the mortgage market has broad impact on the economy and other markets, so any improvement there could bring relief to other markets as well. Of course, the good news doesn't mean the financial crisis is over. The mortgage-market calm is fragile and could easily be undone if, say, default rates again lurch higher, another high-profile financial firm fails or more multibillion-dollar write-downs force banks to curtail lending further and seek emergency capital. "There is no such thing as an all-clear siren at the moment," Mr. Vogel said. "It's too soon to say, 'Dismantle your bomb shelter.'"

Things have improved over the past few days. Yields on Fannie- and Freddie-backed bonds have fallen nearly a full percentage point since rising March 6, a day after Carlyle Capital Corp. disclosed that it couldn't meet margin calls from some of its bankers. The difference on the yield on 30-year mortgage-bonds compared with a blend of U.S. Treasurys fell to 2.74 percentage points, from 2.87 Tuesday, said FTN. That difference, or spread, compared with a 20-year high of 3.7 percentage points March 6.

The disclosure by Carlyle Capital, created by private-equity giant Carlyle Group, proved to be the spark that set a wildfire through mortgage markets and other parts of the financial system. Carlyle Capital held $21 billion in mortgage-backed securities, and investors feared the firm or its bankers would dump them.

That roiled mortgage markets and set off fears of wider financial contagion. This chapter of the credit crisis culminated in the emergency sale of **Bear Stearns** Cos. to **J.P. Morgan Chase** & Co. for just $236 million.

To combat the fear in the markets, the Fed created a new $200 billion lending facility, allowed brokers, not just banks, to borrow funds and financially backed the Bear Stearns sale. Those actions, coupled with Tuesday's interest-rate cut, helped to reverse the climb in mortgage-bond yields.

That brought buyers back into the market. Noted bond investor Bill Gross, who manages the $123 billion Pimco Total Return fund at **Allianz** SE's Pacific Investment Management Co., said in an interview Tuesday that he was actively buying mortgage bonds.

Then yesterday, the regulator for Fannie and Freddie agreed to reduce the amount of capital the firms' have to hold, allowing them to buy or guarantee more mortgages. At the same time Fannie and Freddie agreed to raise more capital, effectively allowing them to buy or guarantee still more bonds. Finally, the board that oversees the nation's Federal Home Loan Banks is close to voting on a plan to raise the amount of mortgage bonds the banks can hold against capital.

The restoration of calm in the mortgage-bond market is likely to have a broad, salutary effect. Lower bond yields translate into lower borrowing costs for would-be home buyers and homeowners looking to refinance.

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